that the Commission might consider, in the future, allowing the BOCs to provide out-of-region interexchange services on a nondominant basis free of any separate affiliate requirement. This possible outcome makes it especially important that the costs of providing interexchange service be recorded according to Part 32. By mandating use of the USOA now, the Commission can avoid later problems arising from the merging of a non-USOA system with the BOCs' existing USOA local exchange service books.

There are also other reasons to require the BOCs' interexchange operations to utilize Part 32 accounting. The audits discussed above found such a lack of documentation that the BOCs' compliance with the Commission's accounting requirements could not be substantiated. The audits also found misclassifications of costs, resulting in overallocations to ratepayers.

These audit findings should serve as a warning for regulators seeking to create a competitively-neutral telecommunications environment. The BOCs' historical unwillingness to adhere to established accounting rules strongly suggests that regulators should put themselves in a position to carefully monitor BOC separate interexchange affiliates. Requiring such affiliates to keep their books pursuant to Part 32 accounting will help achieve that goal by enhancing the ability of regulators to conduct audits. Utilizing the Part 32 USOA helps to ensure that records are kept in a format that is familiar to regulators, and also helps ensure that a sufficient level of detail is maintained. Part 32 accounting also facilitates comparisons between accounts. The costs of imposing this requirement on the BOCs' interexchange affiliates now are low but will become much greater if they begin providing interexchange services without such a requirement.

The Commission should also require the BOCs' interexchange affiliates to keep Part 36 Separations Accounts. Presumably, those affiliates would be offering both interstate and intrastate interexchange services. As discussed above, the Notice suggests that the Commission at some point may decide to permit the BOCs to offer out-of-region interexchange services on a nondominant basis without a separate affiliate requirement. The Commission needs to understand the impact that a joint intrastate (local and interexchange)/interstate offering would have on jurisdictional separations results. Since the separations rules utilize allocators based on usage, it is highly likely that the BOCs' interexchange operations will produce a shift in their jurisdictional revenue requirements. Even in a regulatory system such as price caps, revenue requirements play a key role in sharing obligations and the Commission's ability to monitor earnings on a consistent basis.

CONCLUSION

For the above reasons, the Commission should require the BOCs to offer their out-of-region interexchange services through separate affiliates as dominant carrier services. The Commission should also ensure the effectiveness of those requirements by imposing stringent separate affiliate transaction rules on such affiliates and by requiring such affiliates to keep their books pursuant to Parts 32 and 36 of the Commission's Rules.

Finally, the Commission should commit to respond quickly to marketplace abuses resulting from BOC participation in the interexchange service market. The continued vitality and growth of that industry require no less. The development of the interexchange service market must never again be held hostage to local bottleneck power.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION

By: Frank W. Krogh

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Dated: March 13, 1996

EXHIBIT A

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August 1, 1994

By Messenger

Mr. Richard L. Rosen
Chief, Communications and Finance Section
Antitrust Division
U.S. Department of Justice
555 Fourth Street, N.W.
Washington, D.C. 20001

Re: **Southwestern Bell's Waiver Request to Provide Interexchange Service Waiver No. W0202**

Dear Mr. Rosen:

MCI Communications Corporation ("MCI") submits the attached comments concerning Southwestern Bell's request for an "expedited" waiver to provide interexchange service.

MCI would be pleased to provide any additional information useful to the Department in its evaluation of SWB's petition.

Sincerely yours,

Anthony C Epstein

Anthony C. Epstein

cc: Martin E. Grambow
David W. Carpenter
Michael B. Fingerhut
Robert J. Aamoth

MCI'S OPPOSITION TO SOUTHWESTERN BELL'S REQUEST FOR A WAIVER TO PROVIDE INTEREXCHANGE SERVICE

TO: THE DEPARTMENT OF JUSTICE

MCI Communications Corporation ("MCI") opposes the request of Southwestern Bell Corporation ("SWB") for a waiver to provide certain interexchange services. Memorandum of Southwestern Bell Corporation in Support of Its Motion for an Expedited Waiver of the Modification of Final Judgment to Exempt Out-of-Region Telecommunications Services from the Interexchange Restriction of Section II (submitted to DOJ July 11, 1994) ("SWB Mem.") (Waiver No. W0202).

1. *Consolidated Consideration.* Southwestern Bell's request raises issues closely related to other pending petitions submitted by Bell Operating Companies ("BOCs"). For example, SWB joined three other BOCs in moving to vacate the decree, and grant of that motion would moot this request. Earlier this year, Bell Atlantic requested a similar, but narrower, generic waiver to provide interexchange services outside its region. Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport (submitted to DOJ Jan. 20, 1994) ("BA Request"). As MCI explained in its July 28, 1994, submission to the Court concerning procedures for the motion to vacate, the Department and the Court should consider all of the interrelated pending requests on a coordinated basis.

SWB has certainly not demonstrated any justification for "expedited" treatment of its request. SWB argues that expedited treatment is appropriate because out-of-region services pose no conceivable possibility of competitive abuse. SWB Motion at 2. However, as explained below, the Court has repeatedly rejected precisely this contention, and in any event, SWB proposes to provide interexchange services *inside* as well as outside the region in which it provides local exchange service.

2. *Continuing Dangers of Bottleneck Abuse.* If any summary action were appropriate, it would be to deny, not grant, the request. In decisions ignored by SWB, the Court has consistently rejected petitions by the BOCs to provide interexchange services outside the territories where they control local exchange bottlenecks. *United States v. Western Elec. Co.*, 1989-1 Trade Cas. (CCH) ¶ 68,619 (D.D.C. June 13, 1989); *United States v. Western Elec. Co.*, 673 F. Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283, 300-01 (D.C. Cir.), *cert. denied*, 498 U.S. 911 (1990). The result should be no different here. In responding to a related request by Bell Atlantic, MCI previously explained why the BOCs should not be permitted to provide interexchange services outside the territory in which they provide local exchange service. *See* letter to Richard L. Rosen from Anthony C. Epstein, at 2-8 (dated March 8, 1994) (Wavier No. W0195).

Most importantly, SWB's proposal fails to come to grips with the fact that, even if SWB were to provide inter-LATA services only outside its region, it would be competing directly against other interexchange carriers in the single, nationwide interexchange market. It remains "[t]he plain and universally recognized fact . . . that the market for inter-exchange services is national." *United States v. Western Elec. Co.*, 673 F. Supp. at 543.[1] In its pending request for a broad interexchange waiver, Ameritech confirmed that "today's interexchange business . . . still extends across the nation." Memorandum in Support of Ameritech's Motions to Remove the Decree's Interexchange Restriction, at 9 (submitted to DOJ Dec. 7, 1993) (Waiver No. M0023).

By this waiver, SWB seeks to enter the national interexchange market and to provide both originating and terminating services in over 90 percent of this market (the territories of the other BOCs and independent local exchange carriers), and terminating services in the remainder (its own territory). This petition therefore presents "the principal problem to which section II(D)(1) of the decree is addressed: *the threat of competition by the Regional Companies themselves in the interexchange business.*" *United States v. Western Elec. Co.*, 627 F. Supp. 1090, 1100 (D.D.C.) (emphasis in original), *appeal dism'd*, 797 F.2d 1082 (D.C. Cir. 1986).

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[1] *See* Response of the United States to Comments on Its Report and Recommendations Concerning the Line-of-Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, at 40-41 (filed April 27, 1987) ("1987 DOJ Response").

Interexchange carriers remain dependent on SWB for exchange access in states where SWB retains its local bottleneck. "A Regional Company that competes against such providers everywhere except in its own region would not find it difficult to discriminate against such a provider in its region, thereby damaging the competitor's service and reputation on a national basis." 1989-1 Trade Cas. at 61,266.[2]

This danger is addressed only in the Affidavit of Alfred E. Kahn and William E. Taylor, at 15-16 (Ex. 4 to SWB Mem.) ("Kahn/Taylor Aff."). Although Kahn and Taylor dismiss this risk as speculative or remote or indirect, their reasons do not stand up. Their principal argument is that SWB would not want to jeopardize in-region revenues and profits from access charges. However, SWB would not expect such discrimination to reduce interexchange traffic originating in its region. Kahn and Taylor acknowledge that SWB retains its local monopoly, Kahn/Taylor Aff. 7 ¶ 17 (local exchange carriers "now dominate the provision of telephone service"); *see* Affidavit of Gary S. Becker, at 7 (Ex. 1 to SWB Mem.), so customers in SWB's territory who want to make interexchange calls have no alternative but to continue to use the inter-

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[2] SWB's ability significantly to increase its rivals' costs exists even if SWB controls less than ten percent of local exchange service and even if less than five percent of interexchange traffic originates outside and terminates inside SWB's territory. SWB Mem. 3-4. Nor would structural separation of SWB's interexchange affiliate (SWB Mem. 20) do anything to reduce the dangers of discrimination. *See* Response of the United States to Public Comments on Proposed Modification of Final Judgment, 47 Fed. Reg. 23320, 23336-37 (May 27, 1982).

exchange carriers victimized by discrimination, leaving SWB's access charge revenues undiminished.[3] Although they dismiss the benefits of in-region discrimination as "clearly . . . highly remote and indirect" (*id.*), they offer no explanation or support for this conclusory assertion. Kahn and Taylor also suggest that the risk of enforcement of anti-discrimination rules will deter this conduct, Kahn/Taylor Aff. 15-16, but because such rules do not provide effective protection against discrimination, the prophylactic decree embodied a structural approach. Letter to Richard L. Rosen from Anthony C. Epstein, at 27-28 (dated Feb. 7, 1994) (Waiver No. M0023).

3. *Provision of Terminating Service*. SWB's petition is misleading -- and broader than Bell Atlantic's -- because contrary to its label, SWB seeks authority to provide *in-region* as well as out-of-region interexchange service. SWB proposes to provide terminating services within its region for calls originated outside its region. SWB Mem. 16. In contrast, Bell Atlantic expressly disclaimed any desire to provide terminating services within its region, and it pro-

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[3] In their affidavit for Bell Atlantic, Kahn and Taylor suggested that the incentive to discriminate against interexchange carriers already exists in-region because Bell Atlantic competes with these carriers in providing intraLATA toll services. Exhibit 1, at 14-15, to BA Request. Without any explanation, they drop this argument from their affidavit for SWB. In any event, discrimination in dialing arrangements and access charges for intraLATA toll services has been more than sufficient to enable the BOCs to retain their dominant share of these services. *See* Letter to Richard L. Rosen from Anthony C. Epstein, at 45-46 (dated Feb. 7, 1994) (Waiver No. M0023).

posed that calls originated out-of-region would be terminated in-region by an unaffiliated interexchange carrier selected on a nondiscriminatory basis, by the customer or otherwise. BA Request 31, 35 & n.86.

Provision of terminating services provides significant opportunities for bottleneck abuse. SWB focuses on discrimination on a call-by-call basis, SWB Mem. 16-19, and ignores discrimination involving entire types of services and interconnections. For example, the interface between the interexchange carrier and the local exchange carrier at the terminating end of the call is becoming increasingly sophisticated, particularly with respect to signaling information (for example, passing the number of the calling party for Caller ID services).[6] As a result, BOCs have the ability to discriminate in favor of their long-distance operations in providing new interfaces at the terminating end. SWB's proposal would also apparently permit it to provide 800 service where the calls terminate within its region. This traffic is concentrated at terminating end, giving SWB substantial opportunity to discriminate in-region in favor of its 800 service customers, and against customers of competing interexchange carriers, in filling orders for circuits and providing adequate maintenance and customer support. Similar

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[6] Competitive dangers at the terminating end have long existed. For years before divestiture, MCI sought from the BOCs equal treatment with AT&T in obtaining answer supervision (information whether the called party answered the telephone), and the BOCs delayed providing it to MCI, forcing MCI to rely on costly and less efficient substitutes.

opportunities exist in connection with other interexchange services where traffic is concentrated at the terminating end -- for example, inbound calls to information service providers.

SWB's proposal to use leased rather than owned facilities inside its region to terminate calls does not eliminate any substantial possibility of competitive abuse. The Court has long held that the judgment's prohibition against BOC provision of interexchange services applies equally to resale and facilities-based services because both involve direct competition with legitimate interexchange carriers. *United States v. Western Elec. Co.*, 627 F. Supp. at 1100-01; *see United States v. Western Elec. Co*, 907 F.2d 160, 163 (D.C. Cir. 1990) ("The critical distinction under the decree is not whether the BOC owns the interexchange capacity, but whether it 'provide[s]' interexchange service to its customers").

4. *Continuing Practical Difficulties.* Contrary to SWB's contention (SWB Mem. 16), there has been no change in the "practical difficulties" that the Department cited when it abandoned its erstwhile proposal to permit BOCs to provide interexchange services that neither originate nor terminate in their regions -- difficulties that would only be exacerbated if SWB were allowed to provide terminating services within its region. It remains true that "BOC evasion of an in-region limitation could pose a substantial risk to a major decree objective -- development of effective

interexchange competition." 1987 DOJ Response 24, 27. "Considerable theoretical and evidentiary difficulties . . . would be involved in deciding whether a BOC's marketing and consulting activities related only to permitted out-of-region interexchange services or whether they involved prohibited in-region services as well," and "[o]ther functions that a BOC might perform in interconnecting its intraLATA services and its out-of-region interLATA services with in-region interLATA links procured 'independently' by a private customer could create further definitional and enforcement problems." 1987 DOJ Response at 42-43. For example, how would SWB's proposed limitation apply if it sought to team with the interexchange carrier whose services it resells in-region to respond to an invitation to bid for a private network including both in-region and out-of-region locations, or if SWB provided private line services or 800 services? As the Department concluded in 1987, "ambiguities, definitional disputes, and conflicts with regulatory decisions and policies would be likely to result from attempts by the Department and the Court to define the limits of 'terminating' service in what is essentially a two-way market." 1987 DOJ Response 38.

5. *Irrelevance of the Generic International Waiver.* The generic international waiver does not provide support for SWB's request waiver. *But see* SWB Mem. 27-31. The generic international waiver was careful to limit BOC participation to *foreign* telecommunications markets. For example, that waiver prohibited the BOCs from providing

interexchange services between points in the United States, from owning interexchange facilities in the United States, and from marketing interexchange services in the United States. Order ¶¶ 3-5 (D.D.C. filed Feb. 4, 1993). Contrary to SWB's proposal for its domestic long-distance affiliate, the BOCs' overseas affiliates are required to hand traffic off to unaffiliated carriers on a non-discriminatory basis (for example, proportional return), and they are prohibited from terminating the traffic in the United States, through resale or otherwise. In supporting international waivers, the Department emphasized that discrimination would be unlikely to occur precisely because of these restrictions.[5/] Here, however, SWB proposes to compete directly in the U.S. market against interexchange carriers wholly dependent on SWB in a substantial portion of that market. SWB's incentives, and the risk to competition, would be qualitatively and

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[5/] Memorandum of the United States in Support of Bell Companies' Motion for a Generic Waiver of Section II(D) of the Decree to Permit Them to Provide, Through Foreign Telecommunications Entities, International Telecommunications Between Foreign Countries and the United States, at 5-9 (filed Aug. 11, 1992) ("1992 DOJ Mem."); Memorandum of the United States in Support of the Motions of BellSouth Corporation, Bell Atlantic and Ameritech for Waivers of Section II(D) of the Modification of Final Judgment to Permit Those Corporations to Provide International Telecommunications Between the United States and Australia, at 8 (filed Sept. 27, 1991) ("1991 DOJ Mem."). Other factors also distinguish these international waivers, such as the small significance of revenues from traffic to the petitioning BOC's region, or the minority nature of BOC interests. 1992 DOJ Mem. 7-9 & n.11-12; 1991 DOJ Mem. 10.

quantitatively different than when it competes in overseas markets.[6]

6. *Lack of Effect on Local Exchange Competition.* SWB argues that an independent reason for granting this waiver is to facilitate SWB's ability to provide local competition to other BOCs outside its region, primarily through investments in cellular systems or cable television systems that may eventually provide telephony services. *E.g.*, SWB Mem. 1-2, 4-5, 38-43. However, to the extent that SWB or any other BOC wants to provide local exchange services outside its region, broad interexchange relief is not necessary. As proven by the experience of the BOCs themselves, local service providers -- both wireline and wireless -- can be extremely successful without themselves providing interexchange service, simply by offering equal access to interexchange carriers. To the extent that any limited interexchange relief might be necessary or appropriate, it can and should be granted on a case-by-case basis. SWB itself promptly obtained the interexchange waivers it sought in connection with its acquisition of cable systems in the Washington metropolitan area. *Compare* Order (D.D.C. Sept. 21, 1993) *with* SWB Mem. 41. The BOCs, and SWB in particular, have also separately sought interexchange relief with respect to cellular service.

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[6] SWB's reliance on the GTE experience is equally misplaced. *See United States v. GTE Corp.*, 603 F. Supp. 730, 736-37 (D.D.C. 1983); Letter to Richard L. Rosen from Anthony C. Epstein, at 47 & n.36 (dated Feb. 7, 1994) (Waiver No. M0023).

Furthermore, as MCI has previously explained, the claim that BOCs are going to provide vigorous local exchange competition, or vigorous cable television competition, should be greeted with great skepticism. Letter to Richard L. Rosen from Anthony C. Epstein at 2-5, 12-13, 18-19 (dated Nov. 1, 1993) (Waiver No. W0186); Letter to Richard L. Rosen from Anthony C. Epstein at 7-9 (dated Feb. 1, 1993) (Waiver No. W0192). To MCI's knowledge, no BOC competes as a Competitive Access Provider ("CAP") in the region of any other BOC. The Department found that cellular service has not become a substitute for local wireline service in part because BOCs like SWB have kept the price of cellular service artificially high. *See* Memorandum of the United States in Response to the Bell Companies' Motions for Generic Wireless Waivers, at 14-19 (filed July 25, 1994) (citing internal SWB documents).

For these reasons, the Department should recommend to the Court that it deny SWB's petition.

Dated: August 1, 1994.

CERTIFICATE OF SERVICE

I, Kimberly Nealon, do hereby certify that the foregoing "COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION" were served this 13th day of March, 1996, by first-class mail, postage prepaid, on the following parties listed below:

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Kimberly Nealon

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